Global Property Insight
Retail

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Empty future or brave new world?

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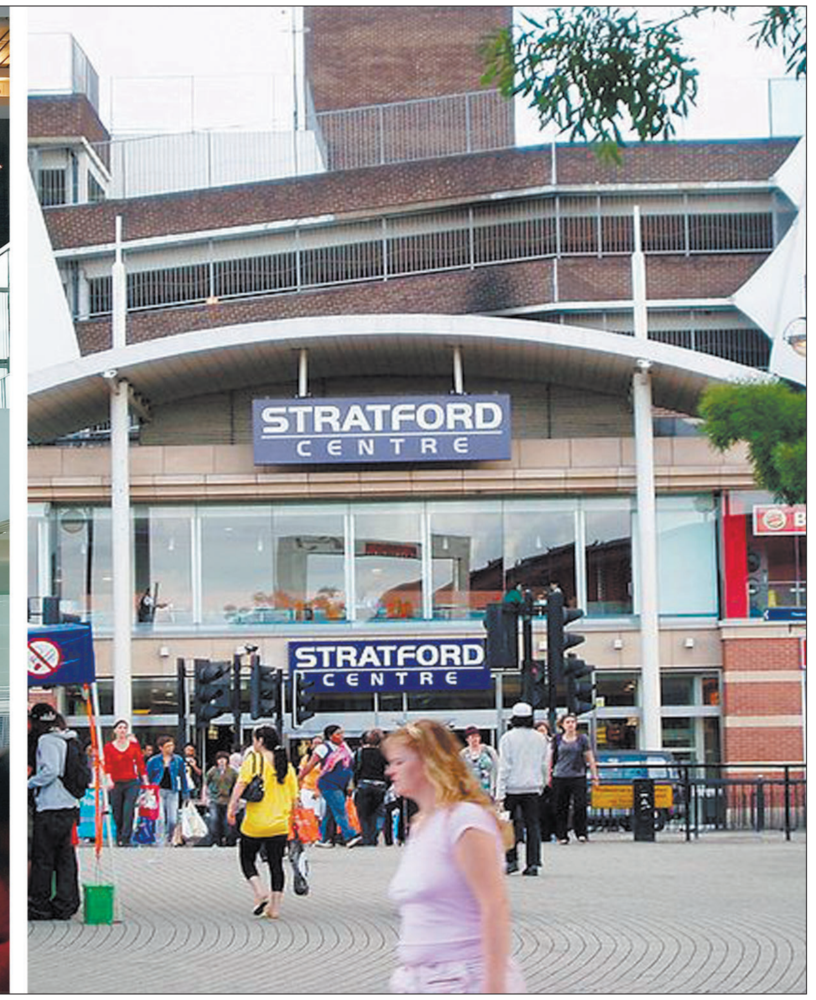

The completion of Westfield (left), far from taking trade away from the Stratford Centre (right), has breathed life into its older counterpart Shaun Curry

A tale of two centres sums up the sector

Ed Hammond explains why investors worry that the future is more uncertain than ever

European property investors and landlords could do worse than look at the story of two UK shopping centres, which captures perfectly the difficulties faced by the sector.

Separated by a few hundred yards of concrete and tarmac, the brushed gold latticework of the new Westfield shopping centre in Stratford, in the east of London, and the diesel-smudged white of the ageing Stratford Centre compete for the same shoppers.

The shops at Westfield, the largest urban shopping centre in Europe, is a roll call of the world's most popular retailers. Upmarket shoe shops jostle with bespoke tailors and eateries offering a spectrum of cuisine and, of course, an Apple store. The Stratford Centre, by contrast, is awash with discount retailers, convenience stores and down-at-heel food kiosks.

The fight for the attention of visiting and local consumers should be a foregone conclusion.

In reality, far from taking trade away from the Stratford Centre, the completion of Westfield this year breathed life into its older counterpart. Footfall is up 30 per cent in two months since it opened and stores are pulling in new customers without shedding regulars. The problem is, it was impossible to predict that this would happen.

As with most areas of UK business, the overarching theme in the retail property sector is that the strong get stronger and the weak weaker as the financial crisis weighs on consumer confidence and bank financing is harder to secure. There are, however, exceptions and the conundrum for landlords is to work out where they lie.

Jonathan De Mello, head of retail consultancy at CBRE, the property group, believes the next round of financial pain will be shared broadly across the retail sector, rather than being borne by the smaller shops.

"Whilst the economy is not officially back in recession as yet, we are very much in a retail recession – with even the likes of Tesco posting negative like-for-likes in a recent trading statement. There are a significant number of retailers struggling to pay down debt, and while some are responding by actively reducing the size of their store portfolios, many still have portfolios where a large percentage of stores still deliver minimal or even negative profit," he says.

"The government ... needs to act soon not just to attempt to save small town centres that are potentially in terminal decline anyway,

> 'We are very much in a retail recession – with even the likes of Tesco posting negative like-for-likes'

but to protect some of the larger retail chains that are clearly very vulnerable."

The issue of tenants falling into insolvency is likely to concern landlords.

To avoid being caught out by retailers unable to meet rents, landlords have moved to a closer dialogue with tenants. As well as getting better visibility over performance, building stronger ties with retailers has allowed landlords to introduce flexibility into rental agreements.

Land Securities, for instance, which manages £4.7bn worth of UK retail property, has moved 15 per cent of tenants to monthly rental payments, compared with a long-running average of just 5 per cent

Among the larger retailers, however, the prevailing predilection is not for shrinking. Far from struggling in the face of economic headwinds, some retailers are eyeing ambitious expansion plans to snatch market share left by the demise of smaller rivals.

At the front of the charge are the supermarkets. Across Europe, large food retailers are adding floor space through a mixture of expanding stores and building new. In the UK alone, the so-called big four supermarket are expected to open about 19m sq ft of capacity between 2010 and 2014.

In addition to creating space for their supermarkets, food retailers are battling to outdo each other in the small convenience store sub-sector, often buying up former pub premises – which come with a licence to sell alcohol – and converting them into mini-markets.

Meanwhile the boom in online shopping is changing the face of the wider retail sector, with consumers increasingly happy to do their shopping without interfacing with the shop itself. The trend, combined with the difficulties many small retailers are facing in meeting rents, is likely to drive a sea change in the structure of the retail property industry.

Simon Hope, head of retail at Savills, says that the big challenge for landlords is how to manage vacant space when it arises.

"The landlords' central job is to make sure any space in their portfolio is filled. If that means bringing in food, cinemas, changing the mix, or even turning some of it over for different uses all together, that is the challenge," Mr Hope explains.

"Vacancy is a demoralising factor for the consumer, so filling the gaps, be it on the high street or in a shopping centre, is fundamental to the success of the shopping area and the consumer shopping experience," he adds.

In a bid to address the issue of having vacant properties, many landlords are looking at alternative uses. One idea is for the retail property sector to follow the example of some office landlords, who have turned underperforming commercial units into housing.

The notion of being able to switch failing secondary retail assets to another, more profitable use, is attracting attention from private equity groups.

Both Lloyds and RBS, the two state-backed banks with large property loan books, have launched sales of distressed retail property assets during the past year. In both cases, the sales have predominantly attracted private equity investors.

Furthermore, the issue of alternative uses for retail property is likely to become increasing important across Europe as the use of the internet by customers grows.

"The decline of the high street in the UK reminds me of the fall of the US 'main street' decades ago. Shoppers love the convenience of driving to shop. If they have that option, that is what most will choose. The decline of the high street has taken longer in the UK because of tougher planning restrictions – it is much harder to build out-of-town centres in the UK than in the US," says John Lutzius, a managing director in Green Street's European team.

Pretty vacant High street future

As the economic slowdown takes its toll across Europe, investors and landlords will be unsettled to see that the latest snapshot of high street vacancy rates in the UK suggests more weathy areas are not immune to recession, writes **Claer Barrett.**

Parts of London are just as likely to have high numbers of boarded-up shops as poorer areas in the north west of the UK.

The latest quarterly shop vacancy statistics produced by the Local Data Company show that in the third quarter of this year [July, August, September] the UK retail market became even more polarised.

Its survey of 329 town centres – containing nearly 80,000 individual shops – shows a "slow and gradual" improvement, with the national vacancy rate decreasing by 0.2 per cent to 14.3 per cent since the beginning of this year.

While this is a far cry from the national vacancy rate of 4 per cent in 2008, there are some interesting regional variations. The extremes range from a 33.7 per cent vacancy rate in Morecambe, in the North West, to zero per cent in Southwold, the affluent seaside town in Suffolk where a beach hut recently changed hands for £60,000.

Of the top five "worst centres" in the UK, when measured by percentages of vacant shops, three locations are in the North West (Morecambe, Leyland North and Stockport) but two are in London – Wandsworth and Kensal Rise – showing that despite the capital's relative affluence, it still has problem areas.

"The good news is that there is stabilisation in the vacancy rate this quarter, but this hides a wider polarisation," says Matthew Hopkinson, director of the Local Data Company, which compiled the report. "Centres in the north west remain at unhealthily high vacancy rates along with the extremes of some secondary centres in London, which continue to deteriorate."

For an expanded version of this story go to www.ft.com/property-nov2011

Global Property Insight: Retail

Space race may bring UK companies down to earth

Supermarkets

Andrea Felsted looks at the latest trend in European expansion

Britain's biggest supermarkets are engaged in a frantic race for space as they seek to expand in their home market.

The UK's so-called big four supermarkets are expected to open about 19m sq ft of space between 2010 and 2014, more than the entire space covered by J Sainsbury today. Waitrose, the grocery arm of the John Lewis partnership, is expected to open about 1m sq ft over the same period.

For the supermarkets, the expansion makes sense as they can steal market share.

But with consumers under pressure, from rising fuel, food and utility bills, the volume of food sold has been falling. Meanwhile competition between the big supermarkets is intensifying.

According to Dave McCarthy, analyst at Evolution Securities, and an early and vocal critic of the supermarket space race, the big supermarkets are caught in a "perfect storm" of overexpansion and slowing market growth.

At the same time, the big four is firing on all cylinders. This is a change from the past when there was always a soft underbelly from which to take market share – in the form of a weaker rival.

Nevertheless, the big grocers are continuing to expand.

"There is a real drive for market share," says Helen Bunch managing director of Wates retail, part of one of the UK's largest construction groups.

One of the main areas of growth is in smaller supermarkets or convenience stores.

Tesco plans to open about 150 convenience stores a year, while J Sainsbury will open between 50 and 100 a year. Asda is adding 140 smaller supermarkets through its £778m acquisition of Netto, while Wm Morrison is trialling a handful of convenience sites. Waitrose will have at least 33 convenience stores by the end of the year, and 53 by the end of 2012.

Smaller stores offer supermarkets the opportunity to forge into neighbourhoods and on to high streets.

They also tap into emerging shopping trends. Increasingly, Britons are shopping locally and more often, in order to manage their cash flows, under pressure from rising fuel, food and utility bills.

In the past six months J Sainsbury has noticed the phenomenon of Britons putting one less item in their basket when they do a big weekly shop. They then buy this item when they do a so-called top-up shop.

"That is leading to a lot more top-up shopping, which is now the driving dynamic in the market place," says Justin King, chief executive of J Sainsbury. He says there is a move to "more local and frequent shopping", as Britons seek to cut down on food waste and save money. Consequently, sales at J Sainsbury's convenience stores rose 20 per cent in the three months to October 1.

Going local: J Sainsbury plans to open between 50 and 100 convenience stores a year AFP

> 'Top-up shopping is now the driving dynamic in the market place'

Some industry experts are beginning to question whether the convenience market is becoming saturated. But Ms Bunch says convenience "still feels an important part [of their plans].

She says supermarkets are now turning their attention to outlets in locations such as university campuses, having already opened outlets in stations and airports

"Definitely people are looking at new options for space," she says.

She adds that supermarkets are also increasingly looking to the "food to go" market. J Sainsbury has opened a sandwich shop in London, while Waitrose could develop a chain of standalone cafés on high streets.

One test of the grocers' appetite for smaller stores will be the auction of Iceland Foods, which has been put up for sale by its majority Icelandic owners.

Both Wm Morrison and Asda submitted first round bids, but many analysts and bankers do not believe that either group wants to pick up the whole of Iceland's 750 stores.

But the flip side of the trend towards convenience shopping is that Britons are eschewing trips to big out of town hypermarkets as they seek to save on petrol and avoid being tempted to buy discretionary items such as a CD or new shirt.

Yet some of the space being added is for non-food items. Extending stores so that they can sell a bigger selection of non-food items is a key part of J Sainsbury's expansion plans.

Wm Morrison has chosen a different route. It bought Kiddicare, an online baby goods retailer, and will use this to build an online platform selling non-food goods. According to Dalton Philips, Wm Morrison's chief executive, building hypermarkets is "madness" because non-food shopping will migrate online.

Meanwhile, competition in the grocery market is intensifying, with price skirmishes becoming more pronounced. Tesco has invested £500m cutting prices on thousands of products, while J Sainsbury has extended a pledge to be cheaper than rivals on a basket of branded goods, or refund the price difference.

Given the step up in competition, the space race is coming under scrutiny from some investors and analysts.

Clive Black, analyst at Shore Capital believes supermarkets are already examining their expansion plans in the light of the tougher trading conditions.

However, both Tesco and J Sainsbury insist their plans remain intact.

But, not everyone is concerned about the dash for new supermarkets.

Philip Dorgan, analyst at Panmure Gordon, points out that the supermarkets expanded aggressively in the 1990s, and this did not have the dire effect on their profits some observers predicted at the time.

In fact, it laid the foundations for Tesco's footprint today.

London's West End provides relief from storms

International

Ed Hammond explains why prices are soaring amid economic storms

The dark windows punctuating the walls of Mayfair's Regency streets would usually be an ominous sign.

Vacant homes have becoming a calling card for the economic and social disintegration that has plagued neighbourhoods throughout western cities during the financial crisis. Here, though, the empty houses are testament to the influx of wealth pouring into the UK's richest neighbourhood, rather than its terminal outflow.

Cash-rich buyers from across Asia, the Middle East and Europe have ploughed billions into London's most coveted houses. Many, however, do not choose to live in the city, leaving their properties empty for months on end.

Now, the same club of international buyers is turning its attention to larger trophies.

"Five years ago, the ownership of shops along Oxford Street and Bond Street was dominated by British and Irish investors. Today, the mix is changing and you are seeing different kinds of buyers entering the market, particularly from wider parts of the globe," says Anthony Selwyn, director of central London research at Savills, the property group.

Savills estimates that on Oxford Street and Bond Street – the capital's main retail thoroughfares – £1bn and £2bn, respectively, of real estate has changed hands during the past five years, leading to a dramatic change in ownership profile. The UK investors, British and Irish pension funds, which once accounted for 96 per cent of ownership on Oxford Street, have reduced their collective stake to 39 per cent having been bought out by investors from Denmark, Spain, Cyprus, Qatar, Libya, Ukraine, India, Hong Kong, Sweden, Canada and Asia.

"The attraction is obvious to any investor with the money to spend: you have seen 50 per cent growth in rental values during the past five years along the two streets and the CrossRail work is only going to add to that trend," Mr Selwyn added.

There have been some high profile transactions during the year to date. Savills acted as agents on the sale of 40-41 Old Bond Street to private investors on behalf of British Airways Pension Fund for an initial yield of 2.74 per cent. Similarly, CBRE, the world's largest property consultancy, has brokered two £40m deals on the streets during 2011 with buyers from Hong Kong.

Phil Cann, a director in CBRE's central London capital markets team, says the investment coming into the city's retail property market is not isolated to Asian buyers.

"If you have £10m in the bank, investors looking at a basket of assets believe equities carry significant risk at the moment and government bonds are an even less attractive option. But retail property in London, particularly at the prime end of the market, with growing rents, is seen as safe by investors and it is also giving pretty healthy relative returns," Mr Cann adds.

During the first half of 2011, some £8.1bn has been invested from non-domestic buyers in the UK commercial property sector, with a significant chunk finding its way to high streets, retail malls, and out of town shopping centres. However, Mr Cann does not think the market in retail or other areas of commercial property has yet seen the crossover of spending from the residential sector.

> 'You have seen 50 per cent growth in rental values during the past five years along the two streets'

In addition to investors coming into the market to take the place of some of the old property funds, retailers, particularly in the luxury brands sub-sector, are buying up stores to strengthen their foothold in the most sought-after trading districts. As well as giving themselves a continuing presence on the street, owning property insulates retailers against the forecasted rising rents. Retailers can also benefit from buying the stores of rivals as it means they can exercise greater control over the market close to their own outlets.

The rampant nature of the demand for retail space along Oxford Street and Bond Street has had a run-off effect on the smaller shopping streets close by, which house some of London's boutique fashion retailers. On Mount Street, for instance, rents have risen 300 per cent since 2006, rising from £110 per square foot to £350 per sq ft.

The sharp rental growth and attraction of holding a big-ticket capital asset likely to hold its value is leading to a wave of deals being done at a significant premium market prices.

"A number of leading overseas occupiers want a presence on the principal retailing streets. In order to secure the keys to the stores, retailers are paying up to several million pounds in premium payments," says Adrian Peachey, European director of capital markets at Jones Lang LaSalle, the property group.

However, much like the residential property in the streets running south towards the river from Oxford Street, the appetite for paying over the odds for the best bricks and mortar London has to offer shows no signs of abating.

"The immediate problem the market is facing is the lack of stock to meet the growing appetite from foreign investors. The weight of overseas capital targeting central London is significantly outstripping the current supply, and there seems no signs of this calming," adds Mr Peachey.

High street heads for Christmas crunch

Tenancies

UK landlords in close dialogue with tenants as rent day approaches, writes **Ed Hammond**

It is early November and the yearly glut of Christmas commercials is in full swing. The assault on consumer consciousness carries a simple message; the more you spend, the better your Christmas will be.

The polished adverts and tempting special offers belie, however, the fragility and desperation of many retailers as the important trading period and the December quarterly rent collection day draws in.

"The million-dollar question for landlords is how hard you push retailers on quarter days," says Tim Leatham, director of shopping centre management at Savills, the property group.

"Some feel that if trading is down and the retailer is struggling, they have to take decisive action because, if they do nothing, they are likely to get no payments if the retailer goes out of business.

"It is hard to know how Christmas will play out and landlords are going to be doing a fair amount of crystal ball gazing and praying for no repeat of the bad weather that affected many retailers last December," Mr Leatham adds.

To tackle the issue of being caught out by retailers unable to meet quarterly rental commitments, most of the large property companies in the UK have started engaging in a much closer dialogue with their tenants. As well as getting better visibility over the performance of individual tenants, building stronger ties with retailers has allowed landlords to introduce more flexibility into the way rental agreements are structured.

Land Securities, which manages £4.7bn ($7.5bn) worth of retail property around the UK, has moved 15 per cent of its tenants to monthly rental payments, compared with a long running average of just 5 per cent.

The move to monthly payments is typical of landlords across the industry and resonates with the economy-wide trend of creditors and debtors working to keep companies afloat.

Some landlords believe, however, that they are being hamstrung in their approach to delinquent or high-risk tenants.

The UK government has made a shift in the wake of the credit crisis to reform its insolvency laws to offer companies greater protection from creditors as they look to restructure themselves.

The move, which includes proposals to reform laws to give companies the right to a court supervised moratorium on debts owing, is similar to a US model of bankruptcy.

In the past year, though, ministers have moved to curb abuse of so-called prepacks by proposing unsecured creditors, such as landlords, be given three days' notice of any plans to sell assets to a connected third party.

"The insolvency laws in this country are all geared towards keeping struggling companies on the drip, rather than protecting the interests of creditors," says a source at one of the UK's largest retail landlords.

However, even if landlords decide to pull the plug, they face an increasingly difficult struggle to fill the vacated space. The issue of filling empty shops, particularly in the country's less financially salubrious high streets and malls, has become so pertinent that analysts expect some properties to be turned over for different uses, such as housing.

For now, though, the main focus for retailers and their landlords will be on getting to the other side of the festive period with as few casualties as possible.

"Having struggled through a year where retail spending has declined in the face of rising household costs, rising unemployment and weakening consumer confidence, this Christmas is likely to be more important than most for many retailers," explains Fergal O'Reilly, director of real estate corporate finance at Ernst & Young.

"In a market where the outlook for consumer spending remains fragile and there is limited scope for some retailers to reduce their cost base further, a poor Christmas trading period could herald another wave of retailer and, as a consequence, landlord failures at the start of 2012."

Special offers abound

It is shop till you drop for global retailers

Expansion

Andrea Felsted finds that international brands plan to continue opening shops


Salad days: Customer assistant Krystal Lee at the first of six Southern California Fresh & Easy branches AP

Despite the clouds descending over the global economy, international retailers are forging into new markets apace.

According to research from CB Richard Ellis, the property consultancy, European retailers are continuing to expand their store networks, sometimes aggressively, despite the challenging consumer environment and an increasing shift towards online shopping.

Peter Gold, head of cross border retail for Europe, the Middle East and Africa at CBRE, expects a similar level of activity among European retailers in 2012 as this year.

"Even with the challenges that the various European economies have suffered since the summer, the appetite for expansion remains," he says.

The research, due to be presented at Mapic, the retail property exhibition, found that 71 per cent of the retailers surveyed are planning to open more than five stores by the end of 2012. This is only slightly less than the 75 per cent who planned this level of activity for 2011.

The report, *How Active are Retailers in Europe, the Middle East and Africa?*, states that in the current climate, all retailers are thinking strategically about which markets to target and how many shops to open.

About 26 per cent of retailers surveyed are taking a cautious approach and choosing to open between one and five stores, compared with 21 per cent last year. But there has also been an increase in the number of retailers looking at large-scale expansion, with one in five retailers planning to open 40 or more stores during 2012. Overall, the level of planned expansion has remained constant.

CBRE found that the top five target markets are Italy, Germany, Russia, Spain and France.

Mr Gold says he was surprised at the growth of interest in the Russian market. "That is definitely going to be a new focus of activity for 2012," he says.

Retailers are also attracted to Germany, due to the stability of its market over the past few years and the relative strength of its economy.

Elsewhere, the Middle Eastern markets of Saudi Arabia, Kuwait and Qatar are enjoying a significant increase in retailer activity, with 15 per cent or more of the store groups surveyed targeting these countries in 2012.

CBRE found that high levels of wealth, more robust economies than Europe and a relative lack of international brands form an attractive combination for retailers. New shopping centres are also being developed here.

But it is not just European retailers that are thinking of expanding. China and the US are increasingly looking beyond their home markets.

> European retailers are expanding store networks, despite the challenging consumer environment

The history of retail is littered with cautionary tales of companies that crossed the Atlantic only to find that, despite a shared language, the US and UK markets suffered from insurmountable difficulties. Best Buy, the US electricals chain, is the most recent to quit the UK, after its so-called "big box" stores failed to live up to expectations.

However, a number of US store groups, including Coach, the accessories retailer, Victoria's Secret, the lingerie chain and Forever 21, the young fashion group, are all expanding into Europe.

Chinese retailers are also active. Bosideng, the clothing retailer, is poised to open a London store. Li Ning, the eponymous sports clothing and equipment chain founded by the former Chinese gymnast, is looking outside its home country, as is upmarket fashion store Shiatzy Chen, which already has a store in Paris.

"It does reflect the maturity and growing confidence of Chinese retailers to move beyond the confines of China and Asia," says Mr Gold.

British retailers continue to expand overseas, with notable examples being Burberry, the luxury goods retailer, and Tesco, the supermarket chain.

Tesco's Fresh & Easy supermarket chain has struggled in the US and the company has now embarked on a revamp. It recently opened its first express store in central Los Angeles. It is also putting bakeries in 100 stores and launching a version of its successful Clubcard loyalty scheme.

Clive Black, head of research at Shore Capital, the stockbroker, says: "This is a crucial time for Fresh & Easy, as it moves towards its goal of breaking even at the end of the 2012-2013 year. By this time next year, we will have a pretty clear feel for whether or not it's going to [do so]. If it does not … then Tesco could look to enter into a joint venture or sell the chain."

According to Colliers International, the property consultant, online shopping will have a profound effect on the international retailing landscape. It says the UK's online penetration is the highest in Europe, but expects other countries to catch up.

Factors that will affect the development of online retail markets in Europe include access to broadband, levels of credit card ownership, consumers' ability to engage in and trust online transactions and the ability of the logistics infrastructure to support online deliveries and returns.

Bricks have more to offer buyers

Online

Claer Barrett explains how landlords are trying to fight back against the web

Shopping at night: the student 'lock in' at St David's shopping centre, Cardiff

Being locked inside a shopping centre at night might be most people's idea of hell, but for student shoppers, it is a fun night out with the chance of a bargain or two.

The phenomenon of "student lock in" shopping nights is a marketing tactic being used by the UK's largest shopping centre owners to generate custom, and encourage young shoppers who have recently moved into the area to spend money in their mall.

After weeks of promotion on social media sites such as Facebook and Twitter, shopping centres close at the normal time, then reopen from 9pm until 11pm, only admitting shoppers who can show a valid National Union of Students (NUS) card.

"We hold these events very infrequently, and plan them months in advance with retailers," says Richard Akers, managing director of retail at Land Securities, which has held student events at its shopping centres in Cardiff and Dundee. "Retailers put on special offers, provide entertainment, food and music to get a real carnival atmosphere going," he says. "At a recent lock-in, one retailer did half of their usual weekly sales within two hours."

Other shopping centre owners, including Hammerson, have held student lock ins inside their own malls, embracing digital media to promote them. These are held in addition to other popular events including the filming of TV programmes such as Gok Wan's *How to Look Good Naked,* which landlords report drastically boost shopper numbers and trade.

"Shopping centres need to position themselves as retail experiences, with a combination of fashion, restaurants and leisure as these are the only really future-proof retail categories from online," says Jonathan De Mello, head of retail consultancy at CBRE.

He points to the newly opened Westfield Stratford City mall in east London, which has a much higher percentage of restaurants and cafés than other malls, designed to cater for the influx of Olympic visitors in 2012.

"More recently developed shopping centres have a significant amounts of leisure uses – cinemas and places to eat – and that's a future trend," agrees Mr Akers of Land Securities. "It provides another reason for people to come, and stay longer."

One of the UK's largest shopping centre owners, Land Securities has brought the convenience of online shopping into seven of his malls, where Amazon collection lockers have been installed. Customers who cannot be at home, or are ordering things too bulky to fit through a letter box, are sent a code and date to pick up their parcel from the shopping centre.

"When customers collect in store, or return an item in store, it's another opportunity to buy. The lockers embody exactly the same concept, and are another way of getting people to come into our shopping centres," Mr Akers argues.

Other landlords are also experimenting. "Mobile commerce poses a further risk to traditional retail, but it also represents an opportunity," says Mr De Mello.

He points to the opening of a special store in the Meadowhall shopping centre in Sheffield designed to make shopping more convenient.

"It's fully endorsed by retailers trading in the scheme, and allows shoppers to scan products via a QR code reader on their smart phones, and order and pay for the product directly without needing to enter the actual store itself," he says.

Speed and convenience is one part of the attraction, but embracing the multi-channel approach can get shoppers to spend more.

Department store House of Fraser recently moved the "click and collect" pick up facility in its London flagship from the back of the store to the middle of the shop floor, reporting that customers are more likely to purchase items in addition to those ordered online, plus find it easier to try on and exchange goods that are not quite right.

It has adapted this approach in Aberdeen and Liverpool – two cities where it does not have department stores, but internet orders prove it has plenty of customers. House of Fraser has opened two small "virtual department stores" – a fraction of the size and cost of a full department store – which can get virtually any product on next day delivery. The stores consist of a customer services area, and banks of changing rooms, making it easy for customers to pick up, try out, pay for or return items.

"There is no question we will see more innovation like this," says Justin Taylor, head of retail at Cushman & Wakefield.

He notes that online-only and catalogue retailers have started to take small numbers of shops, pointing to Boden, the upmarket online fashion retailer, which has a store in Reading and Simply Be, part of N Brown's plus-size clothing catalogue empire, which has stores in Liverpool and Bury.

Another trend is speed. Physical and online retailers are using courier companies to fulfil online orders quickly. London-based firm eCourier boasts Harrods, Jimmy Choo, Net-a-Porter and Matches.com among its retail client base, reporting that requests for same day delivery are growing at 30 per cent a year.

"In today's retail environment, every sale counts," says Ian Cummings, chief executive of eCourier. "Increasingly, retailers and customers are asking us to deliver outside normal business hours, up to 10pm at night and at weekends."

However, the traffic is not all in one direction. Not everyone wants to participate fully in the internet retail experience, as one high street retailer has discovered.

The Original Factory Shop started selling larger household items on its website this year, including beds, garden furniture and bulky children's toys. Angela Spindler, chief executive, reports about 35 per cent of company's online sales are transacted in store, when customers come in to purchase items they have seen online, and arrange delivery. "Some people want to be able to pay in cash, but others prefer face-to-face transactions even if they're paying on card," she says. "Some people are wary of putting their data online, particularly older customers, although it's not restricted to that group. Despite the convenience of the internet, some shoppers would much rather deal with a real person."

Global Property Insight: Retail

Tough times bring opportunities

M&A

Anousha Sakoui explains why the sector is changing

Times are tough in the world of retail dealmaking. Even those being done are often distressed sales: each quarter has seen a decline in M&A volumes.

Retail has been one of the poorest sectors for deals, accounting for the smallest proportion of M&A in the US and Europe, Middle East and Africa (Emea).

The numbers tell it all: in the first nine months of 2011, retail accounted for 4 per cent of M&A in Emea: 1 per cent in the US, according to Thomson Reuters.

However, the volume of global retail M&A has almost doubled from its 2008 lows, but many of the deals being done on the high street are more distressed in nature.

"M&A in the retail sector has largely been driven by sales of distressed assets," says Christine Cross, chief retail and consumer adviser at PwC. "These sales have led to a reduction in the total number of shops."

The trend in retail seems different from other sectors.

"Strategies for growth that attract M&A have trended away somewhat from traditional domestic store growth, with diverse store concepts, multi channel distribution and international expansion via joint ventures/franchises more prevalent," says David Parkes, co-head of the consumer and retail group at SJ Berwin, the lawyers.

Meanwhile, retailers are likely to try to manage the downturn and their rental obligations.

Ms Cross says in 2012: "Landlords will find it difficult to increase rentals for good tenants.

"At the other end of the spectrum, landlords are less likely to be forgiving of tenants who cannot pay rent, after many ended up at the wrong end of a pre-pack last year."

However, insolvencies in the consumer retail sector are down, according to Mergermarket, from $806m last year to $241m in the year to date. Yet the number of distressed deals remains on a par, at 27 (from 28 in 2010).

"Store numbers are reducing as a result of opportunistic M&A rather than traditional consolidation, most notably from distressed purchases from businesses in difficulty or administration," says Andrew Shufflebotham, head of retail and consumer at Addleshaw Goddard, the lawyers.

One example is Kingfisher when it paid £24m to acquire 29 former Focus DIY outlets, which it planned to reopen as B&Q stores, bringing its total investment in the UK to £130m this year: nearly four times the £34m spent in the previous year.

However Habitat, the homeware design brand started by Sir Terence Conran in 1964, this year had to close around 30 UK stores after its owner, turnround specialist Hilco, sold the brand and three of its landmark outlets to Home Retail Group, owner of Argos.

Another way dealmaking is hitting shop numbers, is through the shift towards online retailing.

"M&A in the retail market is driven by various factors, you have the race in to the online space and the move by the grocers to grow their convenience store portfolios," says Tom Leman, partner and head of retail and leisure for lawyers Pinsent Masons.

"Both could be seen as damaging to the high street – the more we acquire online the less we need shops in the high street and the more convenience stores that pop up the less we will need the local high street store – the butcher, the baker etc."

Consolidation does not always lead to a reduction in shops. "M&A has played much less of a role in retail than in other industry in reducing capacity," says Richard Lloyd Owen, head of UK M&A at Deloitte. "You are seeing a reduction in brands, through distressed M&A, but not as much reduction in capacity. Like other industries where there is overcapacity, the number of players in retail has to be reduced, but that hasn't happened much yet."

Mr Lloyd Owen says there will be more consolidation in the sector, which will lead to a reduction in shops. "We will continue to see a reduction in the number brands too," says Mr Lloyd Owen. "Rather than seeing M&A used to improve profits by achieving supply chain synergies or entering new markets, we will see it used to change the financial structure of retailers so the space can be used more profitably."

Rupert Eastell, head of retail at Baker Tilly, says the recession-led consolidation so far in the sector has exacerbated, but not caused, the structural change in the high street, as tertiary high streets were already falling out of favour. "Too many shop units in these high streets are simply too small and inflexible to be fit for purpose for the retailer and customer of 2011," says Mr Eastell. He adds however that a positive consequence of consolidation has been the availability of stores in surprisingly good locations at short notice. "These are fought over by retailers looking for a de-risked revenue opportunity through a pop-up shop with their short term, turnover rent and location being an attractive formula."

Christine Cross: 'M&A in the retail sector has been driven by sales of distressed assets'